

REPORT OF EXAMINATION
OF THE
CIVIL SERVICE EMPLOYEES
INSURANCE COMPANY

AS OF
DECEMBER 31, 2006

Participating State
and Zone:

California

Filed May 20, 2008

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San Francisco, California
April 25, 2008

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Kent Michie
Secretary, Zone IV-Western
Commissioner of Insurance
Department of Insurance, State of Utah
Salt Lake City, Utah

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

CIVIL SERVICE EMPLOYEES INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 50 California Street, Suite 2550, San Francisco, California 94111.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2006. The examination was conducted pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of assets and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances. The examination was

conducted concurrently with that of the Company's wholly-owned subsidiary, CSE Safeguard Insurance Company.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states, loss experience; and sales and advertising.

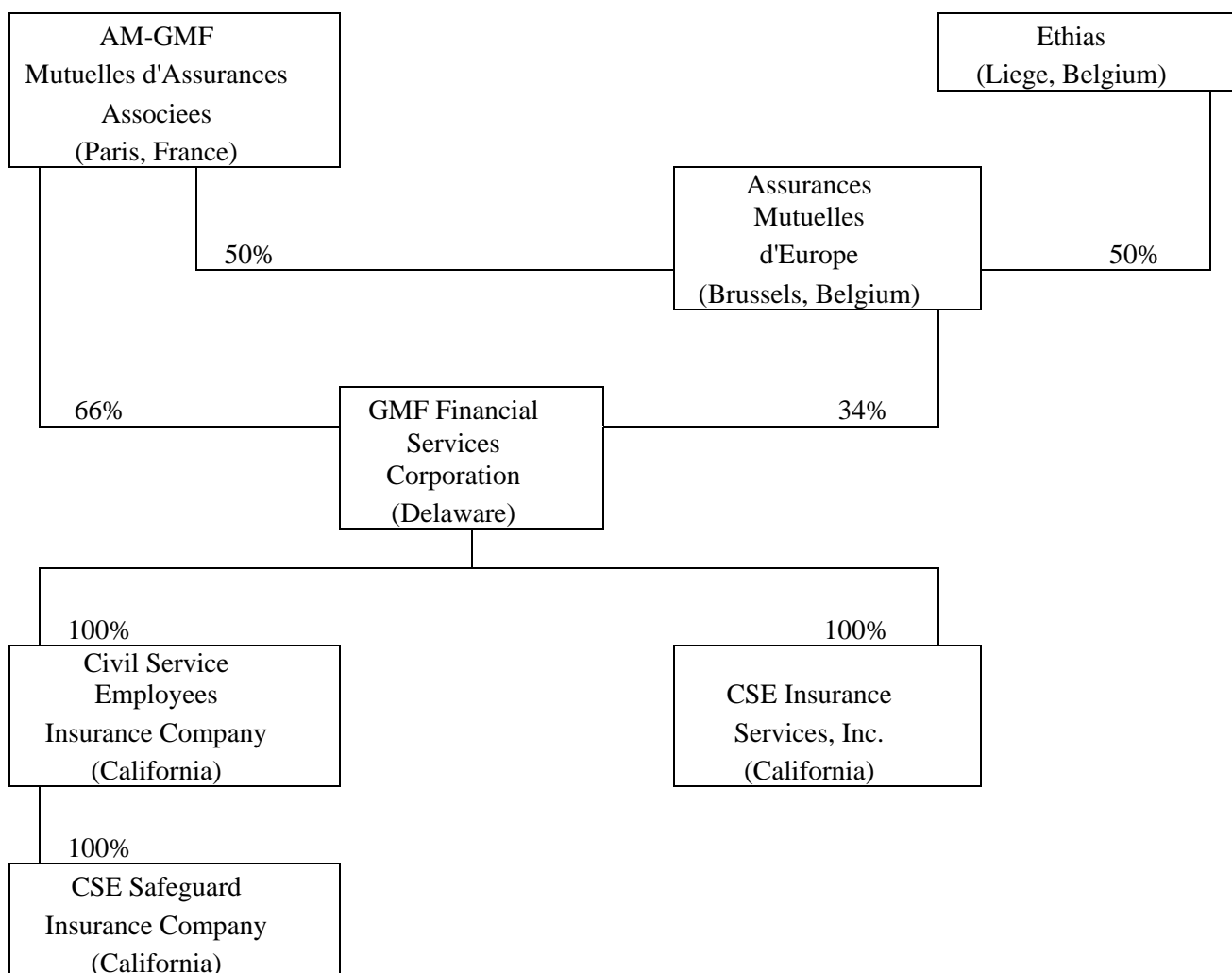
COMPANY HISTORY

The Company paid and received dividends during the examination period as shown in the following schedule. Ordinary material dividends paid in 2005 and 2006 were reported in the annual holding company registration statement as required by California Insurance Code Section 1215.4(b). An extraordinary dividend was received from the Company's subsidiary, CSE Safeguard Insurance Company. The dividend was approved by the California Department of Insurance.

<u>Year</u>	<u>Dividend Paid</u>	<u>Dividend Received</u>
2004	\$ 193,275	
2005	1,500,000	
2006	1,500,000	\$ 6,631,000

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system, of which AM-GMF Mutuelles d'Assurances Associees (AM-GMF) is the ultimate controlling entity. The following chart depicts the inter-relationship of the companies within the holding company system as of December 31, 2006:



Management of the Company is vested in an eight-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2006 follows:

Directors

Name and Residence

Jaaq Baerten
Tongeren, Belgium

Dirk van Berlaer
Brussels, Belgium

Principal Business Affiliation

Deputy Director General
Ethias

Director and Actuary
Ethias

Directors

Name and Residence

Principal Business Affiliation

Sophie Beuvaden
Paris, France

Executive Vice President, Finance
Covea

Pierre Bize
Danville, California

Director, President and CEO
Civil Service Employees Insurance
Company

Jean Fleury
Paris, France

Executive Vice President and General
Secretary
Covea

Véronique Florin ⁽¹⁾
Paris, France

Project Manager, International Operations
Covea

Patrice Forget
La Celle-Saint-Cloud, France

Executive Vice President
GMF Group

Richard J. Miles
San Francisco, California

Retired Executive Vice President, Claims
Civil Service Employees Insurance
Company

Principal Officers

Name

Title

Pierre Bize
Gregory J. Parini
Gardner J. Gray, Jr.

President
Secretary
Senior Vice President and Chief Financial
Officer

John C. Adiletti
Frank V. Querques
David A. Brinker
Kai Y. Fung
F. Lee Baumgartner
Robert M. Adams
James E. Williamson

Senior Vice President, Marketing
Senior Vice President, Insurance Operations
Senior Vice President, Products and Support
Vice President, Actuarial
Vice President, Information and Technology
Vice President, Internal Audit
Vice President, Claims

¹ Replaced in 2007 by Dominique Salvy

Inter-Company Agreements

Tax Allocation Agreement: The Company files federal income taxes on a consolidated basis with GMF Financial Services Corporation (GMFF) and other affiliates. The Company was party to a federal income tax agreement with GMFF effective January 1, 1990. Pursuant to this agreement, GMFF paid all of the Company's federal income tax obligations and in return the Company relinquished its claim to any tax refunds. The Company's wholly-owned subsidiary, CSE Safeguard Insurance Company, had an identical federal income tax sharing agreement with GMFF. On August 17, 2001, the Company received approval from the California Department of Insurance (CDI) to report federal income tax transactions based on the aforementioned agreement. The Company has requested and was granted a permitted accounting practice for this arrangement.

Cost Sharing Agreements: Pursuant to a cost sharing agreement, the Company provided certain insurance-related services to its wholly-owned subsidiary, CSE Safeguard Insurance Company (Safeguard), on a cost reimbursement basis. Services included agency appointments, policy rate and form development, reinsurance, premium collection, and claims settlement. The agreement dated back to January 1, 1996 and has been renewed a number of times since then. The current agreement was effective October 1, 2002 and expired on September 30, 2005.

The Company was party to a second cost sharing agreement effective December 16, 2004 with CSE Insurance Services, Inc. (the Agency), an affiliated insurance agency. Services provided by the Company to the Agency included payroll, accounting, and general administrative expenses on a cost reimbursement basis. The effective and termination dates of this agreement were December 16, 2004 and September 30, 2005, respectively.

Lastly, the Company was party to a third cost sharing agreement with its parent company, GMFF. Services provided by the Company to GMFF included payment of expenses on a cost reimbursement basis and payment of state and federal income taxes by GMFF, for which no reimbursement was due pursuant to the Tax Allocation Agreement. The effective and termination dates of this agreement were October 1, 2002 and September 30, 2005, respectively.

Review of the cost sharing agreements indicated that, although extensions were approved by the board of directors and the Company and its affiliates continued to operate under the terms of the agreements, the agreements had not been signed by the parties, nor had they been amended to reflect the extension date. A similar comment was made in the last examination report. It is recommended that the Company file these cost sharing agreements with the CDI as required by California Insurance Code Section 1215.5(b)(4), as no filing has ever been made.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2006, the Company was licensed to write various lines of property and casualty insurance in the District of Columbia and the following states:

Arizona	Oregon
California	Utah
Colorado	Virginia
Idaho	Washington
Nevada	

Direct premiums written by the Company in 2006 was \$89.5 million in the following primary lines of business: homeowners multiple peril (38.9%), commercial multiple peril (17.2%), private passenger auto liability (16.3%), auto physical damage (14.0%), and fire, allied lines and all other (13.6%). Commercial multiple peril policies were written mostly for condominium and townhouse buildings. The Company's target market was civil servants, but it sold to the general public as well. Territories in which premiums were written were California (89.8%), Nevada (5.8%), Arizona (3.8%), and the remaining states (0.6%). Policies are marketed through approximately 500 independent agents located mostly in California. The Company wrote some earthquake policies, which were 100% reinsured with Lloyd's.

REINSURANCE

Pooling Agreement

The Company has been party to a reinsurance pooling agreement with its wholly-owned subsidiary, CSE Safeguard Insurance Company (Safeguard), since January 1, 1990. The reinsurance pooling agreement was last amended January 1, 2006. The agreement provides for the pooling and distribution of premiums, losses, loss adjustment and underwriting expenses. Under the terms of the agreement, Safeguard cedes 100% of its net writings (after non-affiliated reinsurance) to the Company which in turn retrocedes 33.33% of the combined net writings of both companies to Safeguard. It is recommended this agreement be filed with the California Insurance Department pursuant to California Insurance Code Section (CICS) 1215.5(b)(4), since amendments were made to the agreement and no filing has ever been made.

Assumed

The Company assumed a minor amount of reinsurance from United Insurance Company, a Utah domestic insurer. The business consisted of standard and non-standard auto liability and physical damage assumed on a quota-share basis. The contract was terminated effective April 2007. The Company's remaining liability from this assumption was \$125,000 as of December 31, 2006.

Ceded

The Company was covered under the following multiple layers of excess of loss and quota share contracts at December 31, 2006:

<u>Type of Contract</u>	<u>Reinsurers</u>	<u>Company Retention</u>	<u>Reinsurer's Maximum Limits</u>
Property Excess of Loss	<u>Authorized, Approved or Accredited:</u> Employers Mutual Casualty Company – 3.0% Moters Insurance Corporation – 50.0% Hannover Ruckversicherungs-Aktiengesellschaft – 10.0% Partner Reinsurance Company of the U.S. – 20.0% The Toa Reinsurance Company of America – 12.5% <u>Unauthorized:</u> Shelter Mutual Insurance Company – 4.5%	\$ 400,000 per risk \$1.0 million per occurrence	\$ 3.6 million per risk \$ 4.0 million per occurrence
Property Treaty Excess of Loss	Various Lloyd's Syndicates – (Approved)	\$ 4.0 million	\$ 6.0 million
Property Facultative Excess of Loss	Munich American Reassurance Company – (Authorized)	\$ 10.0 million	\$ 25.0 million
Casualty Excess of Loss	<u>All Authorized:</u> GE Reinsurance Corporation – 32.5% Moters Insurance Corporation – 35.0% Partner Reinsurance Company of the U.S. – 20.0% The Toa Reinsurance Company of America – 12.5%	\$ 300,000 per event \$ 1.0 million per event for ECO/XPL	\$ 700,000 per event \$ 5.0 million per event for ECO/XPL
Personal Umbrella Liability Quota Share	Munich American Reassurance Company – (Authorized)	5% of \$ 1.0 million	95% of \$ 1.0 million and 100% over \$ 1.0 to \$ 5.0 million
Commercial Umbrella Liability Quota share	Munich American Reassurance Company – (Authorized)	5% of \$ 1.0 million	95% of \$ 1.0 million and 100% over \$ 1.0 to \$ 5.0 million

<u>Type of Contract</u>	<u>Reinsurers</u>	<u>Company Retention</u>	<u>Reinsurer's Maximum Limits</u>
Catastrophe Excess of Loss	<u>Various Authorized (A) and Unauthorized (U) Reinsurers:</u> <u>First Layer</u> A - 47.0% , U - 48.0%, Total - 95.0% <u>Second Layer</u> A - 46.5%, U - 48.5%, Total - 95.0% <u>Third Layer</u> A - 38.0%, U - 57.0%, Total - 95.0% <u>Fourth Layer</u> A - 43.0%, U - 52.0%, Total - 95.0% <u>Fifth Layer</u> A - 48.0%, U - 52.0%, Total - 100.0% <u>Sixth Layer</u> A - 59.5%, U - 40.5%, Total - 100.0%	\$ 5.0 million \$ 10.0 million \$ 17.5 million \$ 30.0 million \$ 50.0 million \$ 75.0 million	\$ 5.0 million \$ 7.5 million \$ 12.5 million \$ 20.0 million \$ 25.0 million \$ 25.0 million

After review of the reinsurance contracts listed above, it was noted that the contracts with Munich American Reassurance Company had insolvency clauses that did not comply with CICS 922.2. The Company has already taken action to amend the contracts. Aside from the pooling agreement, total recoverable on paid and unpaid losses at December 31, 2006 was \$84,000 and \$3.3 million, respectively.

ACCOUNTS AND RECORDS

The examination included a review of the Company's general controls over its information systems. A number of weaknesses were noted in areas such as security and access controls, physical security, program change controls, and business continuity planning. The noted weaknesses were presented to the Company along with recommendations to strengthen its controls. It was noted that many of the specific findings from the prior examination continue to exist and have not been addressed. The Company's response to many of the unaddressed findings has been that it will take it under advisement. The Company should evaluate the recommendations and make appropriate changes to strengthen its information system controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Underwriting and Investment Exhibit for the Year Ended December 31, 2006

Reconciliation of Surplus as Regards Policyholders from December 31, 2002
through December 31, 2006

Statement of Financial Condition
as of December 31, 2006

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 80,671,500	\$	\$ 80,671,500	
Common stocks	23,766,010		23,766,010	
Cash and short-term investments	36,530,674		36,530,674	(1)
Aggregate write-ins for invested assets	460,674		460,674	
Investment income due and accrued	1,053,436		1,053,436	
Uncollected premiums and agents' balances in the course of collection	1,076,413	29,752	1,046,661	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	7,401,933		7,401,933	
Amounts recoverable from reinsurers	394,960		394,960	
Electronic data processing equipment and software	407,370		407,370	
Furniture and equipment	431,914	431,914		
Receivable from parent, subsidiaries, and affiliates	4,525,595		4,525,595	
Aggregate write-ins for other than invested assets	<u>2,058,444</u>	<u>1,651,720</u>	<u>406,724</u>	
Total assets	<u>\$ 158,778,923</u>	<u>\$ 2,113,386</u>	<u>\$ 156,665,537</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 32,834,747	(2)
Loss adjustment expenses			13,691,887	(2)
Commissions payable, contingent commissions and other similar charges			1,930,846	
Other expenses (excluding taxes, licenses and fees)			1,758,932	
Taxes, licenses and fees (excluding federal and foreign income taxes)			158,393	(3)
Unearned premiums			34,439,250	
Advance premiums			1,255,588	
Ceded reinsurance premiums payable			466,563	
Funds held by company under reinsurance treaties			1,648	
Amounts withheld or retained by company for account of others			65,367	
Payable for securities			541	
Aggregate write-ins for liabilities			<u>1,758,177</u>	
Total liabilities			88,361,939	
Common capital stock		\$ 3,436,000		
Gross paid-in and contributed surplus		30,057,317		
Unassigned funds (surplus)		<u>34,810,281</u>		
Surplus as regards policyholders			<u>68,303,598</u>	
Total liabilities, surplus and other funds			<u>\$ 156,665,537</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2006

Statement of Income

Underwriting Income

Premiums earned		\$ 74,409,473
Deductions:		
Losses incurred	\$ 30,425,031	
Loss expenses incurred	10,949,066	
Other underwriting expenses incurred	<u>27,564,199</u>	
Total underwriting deductions		<u>68,938,296</u>
Net underwriting gain		5,471,177

Investment Income

Net investment income earned	\$ 4,896,326	
Net realized capital gain	<u>(536,251)</u>	
Net investment gain		4,360,075

Other Income

Net loss from agents' or premium balances charged off	\$ (105,517)	
Finance and service charges not included in premiums	546,863	
Aggregate write-ins for miscellaneous income	<u>59,296</u>	
Total other income		<u>500,642</u>
Net income before federal income taxes		10,331,894
Federal income taxes incurred		<u>0</u>
Net income		<u>\$ 10,331,894</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2005		\$ 55,865,543
Net income	\$ 10,331,894	
Change in net unrealized capital losses	(1,924,640)	
Change in nonadmitted assets	(414,999)	
Change in provision for reinsurance	15,000	
Dividends to/from stockholders	5,131,000	
Aggregate write-ins for losses in surplus	<u>(700,200)</u>	
Change in surplus as regards policyholders for the year		<u>12,438,055</u>
Surplus as regards policyholders, December 31, 2006		<u>\$ 68,303,598</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2006

Surplus as regards policyholders, December 31, 2002, per Examination			\$ 28,285,190
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 22,288,340	\$	
Change in net unrealized capital gains	3,252,519		
Change in nonadmitted assets	4,260,024		
Change in provision for reinsurance	7,480,000		
Dividends to stockholders	3,437,725		
Aggregate write-ins for losses in surplus	<u> </u>	<u>700,200</u>	
Total gains and losses	<u>\$ 40,718,608</u>	<u>\$ 700,200</u>	
Net increase in surplus as regards policyholders			<u>40,018,408</u>
Surplus as regards policyholders, December 31, 2006, per Examination			<u>\$ 68,303,598</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Cash and Short-Term Investments

Although the majority of its investments were held in a qualified custodian as required by California Insurance Code Section (CICS) 1104.9, it was noted that the Company maintained a significant amount of cash and short-term investments at year end with banks which are no longer domiciled in California. In addition, CICS 1104.1 requires moneys and securities in excess of reasonable business needs to be maintained in California. It is recommended the Company deposit its cash and short-term investments with a qualified custodian, subcustodian, or depository located in California pursuant to CICS 1104.1 and 1104.9.

(2) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2006 were found to be reasonably stated and have been accepted for purposes of this examination.

(3) Taxes, Licenses and Fees

CICS 1872.8(a) states, in part, that each insurer doing business in the State of California must pay an annual Vehicle Fraud Assessment Fee for each vehicle insured under an insurance policy it issues in California. The fee provides funding for the increased investigation and prosecution of fraudulent automobile insurance claims and automobile theft in California. The review for the examination period from January 1, 2003 through December 31, 2006 indicated a total underpayment for the four-year period of \$4,136.85.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Intercompany Agreements (Page 5): It is recommended that the Company file its cost sharing agreements with the California Department of Insurance as required by California Insurance Code Section (CICS) 1215.5(b)(4).

Accounts and Records (Page 9): It was noted that many of the specific findings from the prior examination continue to exist and have not been addressed. It is recommended that the Company review the recommendations made regarding its information systems and make appropriate changes to strengthen internal controls.

Comments on Financial Statement Items – Cash and Short-Term Investments (Page 14): It is recommended the Company deposit its cash and short-term investments with a qualified custodian, subcustodian, or depository located in California pursuant to CICS 1104.1 and 1104.9.

Comments on Financial Statement Items – Taxes, Licenses and Fees (Page 14): The Company under reported the vehicle counts supporting the Vehicle Fraud Assessment Fee, as defined by CICS 1872.8. Total underpayment of the Vehicle Fraud Assessment Fee for the four-year period was \$ 4,136.85. It is recommended the Company submit revised filings for this period.

Previous Report of Examination

Management and Control – Intercompany Agreements (Page 6): It was recommended that the Company renew all inter-company agreements prior to their expirations. The Company complied by extending the cost sharing agreements to September 30, 2005, but they were allowed to expire and were never signed by the parties. It was noted the Company's board of directors approved extension of the agreements until December 2007, but the agreements were not revised. Although not recommended in the prior examination, it is now recommended that

the Company file the three cost sharing agreements with the California Department of Insurance pursuant to CICS 1215.5(b)(4).

Management and Control – Conflict of Interest (Page 7): It was recommended that the Company retain a completed set of conflict of interest statements for review at any time. The Company has complied with this recommendation.

Corporate Records (Page 7): It was recommended that the Company comply with CICS 1201 regarding approval of investments by the board of directors. The Company has complied with this recommendation.

Accounts and Records – Information System Controls (Page 12): It was recommended that the Company review its information system controls and address the control weaknesses noted in areas such as information security, program change control, physical security, disaster recovery and business continuity planning. Many of the specific findings from the prior examination continue to exist and have not been addressed. The Company's response to many of the unaddressed findings has been that it will take it under advisement.

Comments on Financial Statement Items – Losses and Loss Adjustment Expenses (Page 17): It was recommended that the Company immediately terminate certain described claims practices and institute controls and supervisory reviews over the claims operation. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the officers and employees of Civil Service Employees Insurance Company during the course of this examination is gratefully acknowledged.

Respectfully submitted,

/S/

Isabel Spiker, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California